

FUNDING AND RESERVES POLICY

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ABBREVIATIONS

DM	Drakenstein Municipality
AO	Accounting Officer
ASB	Accounting Standards Board
CFO	Chief Financial Officer
CRR	Capital Replacement Reserve
GRAP	Generally Recognised Accounting Practise
IDP	Integrated Development Plan
MFMA	Municipal Finance Management Act
MSA	Municipal Systems Act
VAT	Value Added Tax
SDBIP	Service Delivery and Budget Implementation Plan

1. PURPOSE OF THIS DOCUMENT

This policy sets out the principles for determining the following:-

- Projected billings, collections and all direct revenues;
- The provision for revenue that will not be collected;
- The funds the Municipality can expect to receive from investments;
- The proceeds the Municipality can expect to receive from the transfer or disposal of assets;
- The funds to be set aside in reserves.

2. DEFINITIONS

In this Policy, unless the context otherwise indicates, a word or expression to which a meaning has been assigned in the Local Government: Municipal Finance Management Act, 2003 (Act No 56 of 2003), has the meaning so assigned, and:

“Accounting Officer” – means the Municipal Manager and vice versa;

“Act” – means the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003);

“Chief Financial Officer” – means an officer of the Municipality, designated by the Municipal Manager to be administratively in charge of the financial affairs of the municipality;

“Council” or “Municipality” – means the Municipal Council of Drakenstein Municipality as referred to in Section 18 of the Municipal Structures Act;

“Creditor” – in relation to a municipality, means any person or service provider to whom money is owing by the Municipality;

“Debt” – means –

- (a) a monetary liability of obligation created by a financing agreement, note, debenture, bond, overdraft or the issuance of municipal securities; or

- (b) a contingent liability such as that created by guaranteeing a monetary liability or obligation of another.

“Delegate” – means an official / person delegated to perform tasks on behalf of another person;

“Financial Statement” – means statements consisting of at least –

- (a) a balance sheet (statement of financial position);
- (b) an income statement (statement of financial performance);
- (c) a cash-flow statement;
- (d) any other statements that may be prescribed; and
- (e) any notes to these statements.

3. PREAMBLE

The Local Government: Municipal Finance Management Act No 56 of 2003 (*hereafter MFMA*) section 18 requires that an annual budget may only be funded from:

- (a) Realistically anticipated revenues to be collected;
- (b) Cash backed accumulated funds from previous years' surpluses not committed for other purposes; and
- (c) Borrowed funds, but only for capital projects.

Section 19 of the MFMA also requires spending on a capital project may only be commenced once the funding sources have been considered, are available and have not been committed for other purposes,

The Local Government: Municipal Finance Management Act No 56 of 2003 Municipal Budget and Reporting Regulations, 2009 Section 8 requires that each Municipality should have a Funding and Reserves Policy.

4. OBJECTIVES

The objectives of the policy relating to funding and reserves are as follows:

- (a) To comply with the legislative requirements;
- (b) To ensure that the Municipality's Operating and Capital budgets are adequately funded;
- (c) To ensure that the Municipality's provisions and reserves are maintained at the required levels, in order to mitigate unfunded liabilities in future financial years; and
- (d) To achieve financial sustainability with acceptable levels of service delivery to the community.

5. APPROVAL AND EFFECTIVE DATE

The policy will be effective as from 1 July 2017.

6. POLICY AMENDMENT

The AO must–

- (a) at least annually review the implementation of this Policy; and
- (b) when the AO considers it necessary, submit proposals for the amendment of this Policy to the Council.

The review of this policy and any amendment should be made with due consideration and in conjunction with the annual review of the budget related policies as prescribed in the Municipal Budget and Reporting Regulations, 2008.

7. RELATIONSHIP WITH OTHER POLICIES

This policy needs to be read in conjunction with other relevant adopted policies of the municipality, including the following:

- Accounting Policy;
- Cash Management and Investment Policy
- Long Term Financial Sustainability Policy;
- Long Term Financial Plan (Chapter 5 of IDP)
- Prioritisation model for Capital Assets Investment
- Borrowing policy

8. REFERENCES

The following references were observed in compiling this document:

- Municipal Finance Management Act, 2003
- Municipal Systems Act, 2000
- Municipal Structures Act, 1998
- Accounting Standards Board
- MFMA Budget Circulars
- Municipal Budget and Reporting Regulations, 2008
- Government Gazettes (30013 & 31021)
- Generally Recognised Accounting Practice

9. PRINCIPLES REGARDING THE FUNDING OF THE ANNUAL BUDGET

9.1 An annual budget may only be funded from:-

9.1.1 Realistically anticipated revenues to be collected;

9.1.2 Cash backed accumulated funds from previous years surpluses and reserves not committed for any other purpose; and

9.1.3 Borrowed funds but only for the capital budget.

9.2 Realistic anticipated revenue projections must take into account:-

9.2.1 Projected revenue for the current year based on collection levels to date; and

9.2.2 Actual revenue collected in previous financial years.

9.3 Spending on a capital project may only occur if:-

9.3.1 The money for the project, excluding the cost of feasibility studies, has been appropriated in the budget;

9.3.2 The project, including the total cost, has been approved by Council;

9.3.3 The sources of funding have been considered and have not been committed for other purposes;

9.3.4 Council has considered:-

9.3.4.1 The projected cost covering all financial years until the project is operational; and

9.3.4.2 The future operations costs and revenue on the project, including municipal tax and tariff implications.

10. FUNDING THE OPERATING BUDGET

- 10.1 The operating budget provides funding to departments for their medium term expenditure as planned.
 - 10.1.1 The Municipality categorises services rendered to the community according to its revenue generating capabilities as follows:-
 - 10.1.2 Trading services (services that generate predetermined surpluses that can be used to fund other services rendered by the Municipality);
 - 10.1.3 Economic services (services that should at least break-even, but do not necessarily generate any surpluses to fund other services rendered by the Municipality);
 - 10.1.4 Rates and General (services that are funded by property rates, government grants or surpluses generated by the trading services).
 - 10.2 The operating budget is funded from the following main sources of revenue:-
 - 10.2.1 Property rates;
 - 10.2.2 Service charges;
 - 10.2.3 Government grants and subsidies;
 - 10.2.4 Other sundry revenue, such as fines, interest received etc; and
 - 10.2.5 Cash backed accumulated surpluses from previous years not committed for any other purposes.
 - 10.3 The following guiding principles apply when compiling the operating budget:-
 - 10.3.1 The annual budget must be cash backed;

- 10.3.2 Growth parameters must be realistic taking into account the current economic conditions;
- 10.3.3 Tariff adjustments must be realistic, taking into consideration affordability, bulk increases and future projected growth according to the approved Integrated Development Plan (IDP);
- 10.3.4 Revenue from government grants and subsidies must be in line with allocations gazetted in the Division of Revenue Act and Provincial Gazettes;
- 10.3.5 Revenue from public contributions, donations or any other grants may only be included in the budget if there are acceptable documentation that guarantees the funds such as:-
 - 10.3.5.1 A signed service level agreement;
 - 10.3.5.2 A contract or written confirmation; or
 - 10.3.5.3 Any other legally binding document.
- 10.3.6 Property rates are levied according to the Municipal Property Rates Act and Property Rates Policy based on the market values. The budget is compiled using the latest approved Valuation Roll and any Supplementary Roll, consistent with current and past trends. Property rates tariffs and rebates are determined annually as part of the tariff setting process;
- 10.3.7 Property rates rebates, exemptions and reductions are budgeted either as revenue foregone or as a grant as per MFMA Budget Circular 51 depending on the conditions thereof;
- 10.3.8 Projected revenue from service charges must be realistic based on current and past trends with expected growth considering the current economic conditions. The following factors must be considered for each service:-
- 10.3.9 Metered services comprising of electricity and water:-

- 10.3.9.1 The consumption trends for the previous financial years;
- 10.3.9.2 Envisaged water restrictions or load shedding when applicable; and
- 10.3.9.3 Actual revenue collected in previous financial years.

- 10.3.10 Refuse removal services:-
 - 10.3.10.1 The actual number of erven receiving the service per category; and
 - 10.3.10.2 Actual revenue collected in previous financial years.

- 10.3.11 Sewerage services:-
 - 10.3.11.1 The actual number of erven receiving the service per category and the size per erven, per category; and
 - 10.3.11.2 Actual revenue collected in previous financial years.

- 10.3.12 Rebates, exemptions or reductions for service charges are budgeted either as revenue foregone or as a grant as per MFMA Budget Circular 51 depending on the conditions thereof;

- 10.3.13 Other projected revenue is charged in terms of the approved sundry tariffs and fines considering the past trends and growth for each category.
 - 10.3.13.1 Provision for revenue that will not be collected is made against the expenditure item debt impairment and is based on actual collection levels and taking into account factors such as ownership, reconnections and type of debtors.

- 10.3.14 Transfers from the accumulated surplus to fund operating expenditure will only be allowed for specific once-off projects and with no recurring operating expenditure resulting thereof.

- 10.3.15 Interest received from actual long-term and or short-term investments are based on the amount reasonably expected to be earned on cash amounts available during the year according to the expected interest rate trends.

- 10.3.16 Depreciation charges are fully budgeted for according to the asset register and to limit the impact of the implementation of Asset Related GRAP Standards a transfer

is made from the accumulated surplus.

- 10.3.17 To ensure the health of the municipal asset base, sufficient provision must be made for the maintenance of existing and infrastructure assets based on affordable levels as maintenance budgets are normally lower than the recommended levels. As a guiding principle repair and maintenance should constitute at least between 7% of total operating expenditure and should annually be increased incrementally until the required targets are achieved.
- 10.3.18 Individual expenditure line items are to be revised each year when compiling the budget to ensure proper control over operating expenditure. Increases for these line items must be linked to the average inflation rate and macro-economic indicators unless a signed agreement or contract stipulates otherwise.

11. FUNDING THE CAPITAL BUDGET

11.1 The municipality's objective is to maintain, through proper maintenance and replacement measures, existing levels of service and to improve and implement services which are neglected or non – existent. In order to achieve this objective the municipality must annually, within financial means, budget for the replacement of redundant assets as well as new assets. The capital budget provides funding for the Municipality's capital programme based on the needs and objectives as identified by the community through the Integrated Development Plan and provides for the eradication of infrastructural backlogs, renewal and upgrading of existing infrastructure, new developments and enlargement of bulk infrastructure. Provisions on the capital budget will be limited to availability of sources of funding and affordability. The main sources of funding for capital expenditure are:-

11.1.1 Cash backed accumulated surpluses;

11.1.2 Borrowings;

11.1.3 Government grants and subsidies;

11.1.4 Public donations and contributions; and

11.1.5 Operating revenue.

11.2 The following guiding principles apply when considering sources of funding for the capital budget:-

11.2.1 Government grants and subsidies:-

11.2.1.1 Only gazette allocations or transfers as reflected in the Division of Revenue Act or allocations as per Provincial Gazettes may be used to fund projects (including unspent grants from prior years);

11.2.1.2 The conditions of the specific grant must be taken into consideration when allocated to a specific project; and

- 11.2.1.3 Government grants and subsidies allocated to specific capital projects are provided for on the relevant department's operating budget to the extent that the conditions will be met during the financial year.
- 11.2.2 In the case of public contributions, donations and/or other grants, such capital projects may only be included in the annual budget if the funding is guaranteed by means of:-
 - 11.2.2.1 A signed service level agreement;
 - 11.2.2.2 A contract or written confirmation; and/or
 - 11.2.2.3 Any other legally binding document.
- 11.2.3 Public donations, contributions and other grants are provided for on the relevant department's operating budget to the extent that the conditions will be met during the financial year.
- 11.2.4 The borrowing requirements as contained in the Borrowing Policy are used as a basis to determine the affordability of external loans over the Medium Term Revenue and Expenditure Framework.
- 11.2.5 All capital projects have an effect on future operating budgets. The following cost factors should therefore be considered before approval:-
 - 11.2.5.1 Additional personnel cost to staff new facilities once operational;
 - 11.2.5.2 Additional contracted services, such as security, cleaning etc.
 - 11.2.5.3 Additional general expenditure, such as services cost, stationery, telephones, material etc.
 - 11.2.5.4 Additional other capital requirements to operate the facility, such as vehicles, plant and equipment, furniture and office equipment etc.
 - 11.2.5.5 Additional costs to maintain the assets;
 - 11.2.5.6 Additional interest and redemption in the case of borrowings;

11.2.5.7 Additional depreciation charges;

11.2.5.8 Additional revenue generation. The impact of expenditure items must be offset by additional revenue generated to determine the real impact on tariffs.

All Reserves are “ring fenced” as internal reserves within the accumulated surplus, except for provisions as allowed by the General Recognised Accounting Practices (GRAP).

The following ring fenced reserves exist:-

12. CAPITAL REPLACEMENT RESERVE

Funding for capital budgets of future financial years are generated through contributions from the operating budget. Once the Municipality has reached its maximum gearing ability no further borrowings can be taken up. This necessitates that the Municipality also invests in a capital replacement reserve. However, it must be cash backed.

This reserve once fully established will enable the Municipality to provide internal funding for its capital replacement and renewal programme. Other contributions to the capital replacement reserve through the operating budget may include interest received on investments.

This reserve must be cash backed at all times to ensure the availability of cash to fund the municipal capital programme.

13. REVALUATION RESERVE

The surplus arising from the revaluation of land and buildings is credited to a non-distributable reserve. The revaluation surplus is realised as re-valued buildings are depreciated, through a transfer from the revaluation reserve to the accumulated surplus/ (deficit). On disposal, the net revaluation surplus is transferred to the accumulated surplus/ (deficit) while gains or losses on disposal, based on re-valued amounts are credited or charged to the Statement of Financial Performance. GRAP 17 governs the reserve and accounting treatment thereof.

14. PROVISIONS

A provision is recognised when the municipality has a present obligation as a result of a past event and it is probable, more likely than not, that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Provisions are revised annually and those estimates to be settled within the next twelve (12) months are treated as current liabilities.

The municipality has the following provisions:

15. LEAVE PROVISION / ACCRUAL

Liabilities for annual leave are recognised as they accrue to employees. An annual provision is made from the operating budget to the leave provision.

16. LANDFILL REHABILITATION PROVISION

The landfill site rehabilitation provision is created for the current operational site at the future estimated time of closure. The value of the provision is based on the expected future cost to rehabilitate the landfill site. The short-term portion provision must be cash backed, to ensure availability of cash for rehabilitation on closure.

17. PROVISION FOR LONG SERVICE AWARDS

Municipal employees are awarded leave days according to years in service at year end. Due to the fact that not all long service leave balances are redeemed for cash.

Long service awards can be encashed at the discretion of the Municipal Manager and will be subject to the cash flow position of Council.

18. PROVISION FOR POST EMPLOYMENT MEDICAL BENEFITS AND EX-GRATIA PENSION BENEFITS

The municipality provides retirement medical care benefits by subsidizing the medical aid contributions to retired employees and their legitimate spouses. The entitlement to retirement medical benefits is based on employees remaining in service up to retirement age and the completion of a minimum service period. The expected cost of these benefits is accrued over a period of employment.

19. POLICY IMPLEMENTATION

This policy will effective as from 1 July 2017.